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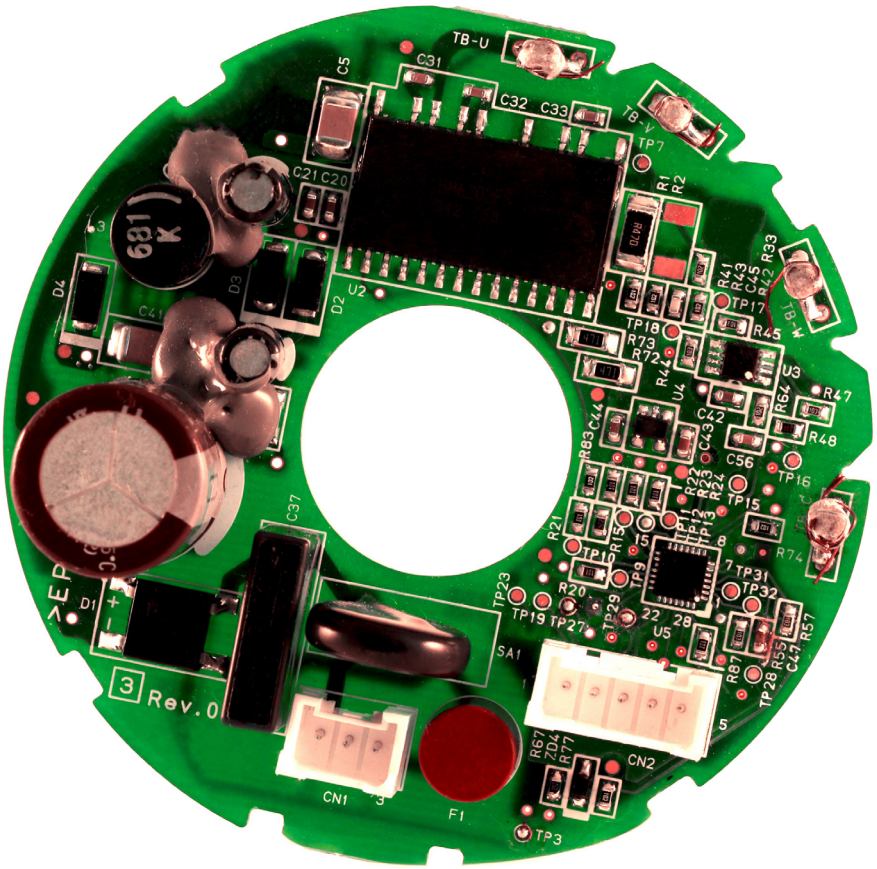

New revenue standard issued

Potential challenges in the technology industry

The new revenue recognition standard will likely present different levels of complexity for many technology companies including challenges in revenue reallocation, transaction pricing, contract modification adjustments, and new disclosures.

Background

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update, *Revenue from Contracts with Customers* in May 2014. The standard provides companies with a single model for use in accounting for revenue arising from contracts with customers, and supersedes current revenue recognition guidance, including industry-specific revenue guidance. The core principle of the model is to recognize revenue when control of the goods or services transfers to the customer, as opposed to recognizing revenue when the risks and rewards transfer to the customer under the existing revenue guidance.

The effective date for public registrants has been deferred to 2018 for calendar year-end

(annual reporting periods beginning after December 15, 2017). Early adoption as of the original effective date (2017 for calendar year-end) is permitted. The guidance permits companies to either apply the requirements retrospectively to all prior periods presented, or apply the requirements in the year of adoption, through a cumulative adjustment.

The delayed effective date and transition options are intended to allow companies a reasonable timeframe to comply. However, addressing some areas of the FASB Accounting Standards Codification may require longer lead-time, particularly related to revenue or billing systems where separation and/or allocation changes may be required, so companies should perform a preliminary analysis of the new requirements on a timely basis.

Considerations and challenges

The requirements in the standard may present complexity for many companies in the technology industry. Examples of some of the challenges are as follows:

Revenue allocation — Under the standard, the performance obligations (i.e., the unit of account under current literature) may not be consistent with current accounting policies or existing billing practices. Judgment may be required to appropriately identify all performance obligations in a contract, particularly for software licenses or SaaS arrangements where access to software is often bundled with other services, such as design, hosting, post-contract customer support, and when-and-if-available upgrades. Allocation of the transaction price may change since the allocation requirements for software arrangements (i.e., vendor-specific objective evidence) and the current hierarchy for other multiple-element arrangements is being replaced by estimated stand-alone selling prices. Companies may need to develop a systematic solution to reallocate revenue and to account for the resulting contract asset or liability. Additionally, the data to perform the calculations (e.g., standalone selling price, contract term, transaction price) may be in multiple systems and may not currently meet applicable control requirements.

Transaction price calculations — Total consideration that the entity expects to be entitled to from the customer over the contract term (i.e., transaction price) may need to be estimated at contract inception and throughout the contract term. Companies may need to develop methods to calculate or estimate the transaction price, including the impact of discounts, rebates, performance bonuses and sales returns, and may also need a well-defined process to update these estimates for each reporting period. It will also be important to consider data maintenance requirements relative to the transaction price.

Licenses — The implementation guidance for licensing and rights to use may cause a change in the recognition patterns of license revenue, as companies will be required to determine both if a license is distinct from other performance obligations and, if so, whether the license provides access (over time recognition) or a right to use (point in time recognition). These determinations could significantly change the timing over which companies recognize license revenue.

Contract combinations and modifications — The standard changes the way certain contracts are accounted for and analyzed. Companies may need to address the potential combination of contracts with the same customer (where pricing dependencies exist) and the potential reallocation of revenue across contracts. On-going adjustments resulting from contract modifications may also be required. These changes might cause some companies to enhance their contract management systems and processes.

Capitalization of costs to acquire customer contracts — The standard requires certain contract costs, including costs to acquire a contract with a customer (e.g., sales commissions), be capitalized and amortized. As a result, companies may need to develop or enhance process, controls, and systems to identify and account for such capitalized costs.

Disclosures — The disclosure requirements under the standard are significant and may require modification to financial and management reporting processes and systems. This may particularly be the case for longer term contracts. Additional disclosures include, but are not limited to, disaggregation of revenue, certain information about changes in contract asset and liability balances and contract costs, and information related to the amount of the transaction price allocated to performance obligations not yet satisfied.

Tax — Certain tax implications may arise as taxpayers often follow the financial reporting revenue recognition methods in the determination of taxable income and transaction tax obligations. The changes may have cash tax implications, may require federal tax accounting method changes, or give rise to new tax temporary differences that may need to be captured, calculated, and tracked through tax provision processes and systems. Taxpayers who do not follow financial reporting methods for tax may also need to consider the impact of these changes on tax reporting and may need to change their computations and procedures, as well as consider potential tax method changes. Similar implications may arise in foreign jurisdictions that impose tax based upon statutory reporting maintained under either International Financial Reporting Standards or U.S. Generally Accepted Accounting Principles, as this change may impact both standards.

Other implications

Organizations may need to consider other project needs, including:

- Implementation of updated or new processes, controls, and systems, where required
- Determination of new monthly closing process steps to accommodate the new requirements
- Steps to estimate the impact of the new standard, to facilitate understanding and planning by other key stakeholders
- Effective training and communication of new requirements
- Effective program and resource management related to this effort

Getting started

Some effective first steps to consider as you begin to evaluate the implications of the potential new standard may include:

- Evaluating significant revenue streams and key contracts to identify the specific revenue recognition changes required and the specific business units where these changes may have the greatest impact
- Addressing the longer lead-time areas where new calculation rules or revised allocation processes may be required

- Establishing a granular project plan and roadmap to manage the effort across multiple business units and countries

How Deloitte Advisory can help

We have an experienced team of professionals, both in the U.S. and globally across the member firms of Deloitte Touche Tohmatsu Limited, who can assist in developing an action plan to help you implement the new revenue recognition standard.

These capabilities include the full breadth of services and competencies needed to help clients address these issues, and would include accounting assistance, help with process revisions, support in making system changes (including development of system business requirements), tax and other matters.

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